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SUBJECT: OVERVIEW OF JAPANESE BUSINESS ON SAKHALIN

1. Summary. Vladivostok Political Officer met with members of the Japanese community on Sakhalin to discuss the region from the Japanese perspective. Though the number of Japanese citizens living on the island has dwindled in recent years, many remain as part of the Sakhalin II oil and gas project. The presence of a Japanese Broadcasting Corporation bureau in the city shows that there is a certain level of interest in the region, and Hokkaido-based businesses are involved in some local construction projects.

2. During his recent trip to Sakhalin, Vladivostok Political Officer met with Mr. Kobayashi, Consul for Political and Economic Affairs at the Japanese Consulate in Yuzhno-Sakhalinsk to discuss Japanese economic activity on the island. He said that the number of Japanese citizens on the island has decreased from over 300 two years ago to 173 today. Most of those remaining are related to the oil and gas industry. There are still about 100 ethnic Japanese who continued to live on the island after the end of World War II.

3. Kobayashi acknowledged that apart from Mitsui and Mitsubishi, which are partners in the Sakhalin II project, there is very little Japanese investment on the island. He mentioned that Korean investors are significantly more active there. Kobayashi suggested that the "incident with the Santa Resort Hotel" is the likely reason for this. That hotel is considered the first world-class hotel on Sakhalin, and was constructed about ten years ago by a group of Japanese investors. The original owners were eventually pressured -- both through the courts and "face to face" -- to sell the hotel to a locally-owned holding company. The hostile takeover made a strong impression on Japanese investors who, according to Kobayashi, have been left with a negative impression of property rights for foreign investors in the region.

4. Though there has been little Japanese direct investment in recent years, there are some Russo-Japanese partnerships. Two Japanese companies have signed deals with local companies to license specialized cold-weather equipment and materials for use in residential and road construction. Many new high-end apartments and houses built in the region now use insulation and other materials from a Hokkaido-based company. Another Hokkaido company is involved with weather-proofing roads and parking lots. A lumber company was also reportedly looking into harvesting spruce trees -- a material used in residential construction on that island -- but the project was deemed unprofitable because of the high cost of accessing the remote spruce forests.

5. At least one local business is counting on Japanese oil workers and visitors to make up a large part of its clientele. Poloff talked to the Russian manager of a newly-opened indoor golf driving range who said the investors had opened the facility specifically with Asian businessmen in mind.

6. Poloff also met with a reporter with the Japan Broadcasting Corporation (NHK) whose office is situated above the Japanese

Consulate. He stated that there is significant demand for news about Sakhalin in Hokkaido, where his stories are broadcast. He attributes this not only to geographical proximity and historical ties, but also to interest in the Ainu people of Sakhalin, an indigenous ethnic group that also populates Hokkaido and the Kuril Islands.

Comment

17. The Sakhalin II oil and gas project remains the focal point for Japanese business on Sakhalin. There is very little other direct investment from Japan, as Japanese investors may still view the hostile takeover of a Japanese-owned hotel as an indication of insufficient legal protection. The presence of the NHK bureau on Sakhalin may indicate general historical and cultural interest in the island, though it may also serve as a way to remind Japanese constituents about the Kuril Islands issue.

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